Supreme Court, U.S.
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No. _____

# In the Supreme Court of the United States

PROFESSIONAL MANAGEMENT ASSOCIATES, INC. EMPLOYEES' PROFIT SHARING PLAN, ON BEHALF OF ITSELF AND ALL OTHERS SIMILARLY SITUATED,

*Petitioner,*

v.

KPMG, LLP,

*Respondent.*

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

## PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED FOR REVIEW

I. Is a putative class action removed from state court in which plaintiff asserts state common law and statutory claims in connection with its holding of a "covered security" within the meaning of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), 15 U.S.C. §§ 77p(b)-(c), 78bb(f)(1)-(2) (2000), where plaintiff alleges misrepresentations and omissions of material facts that began before the class period but alleges no purchases or sales made in reliance upon, and seeks no damages for, the pre-class period misrepresentations or omissions, a "covered class action" within the meaning of SLUSA?

II. Did the Court of Appeals exceed its jurisdiction under Article III of the United States Constitution in holding that plaintiff "implicitly" alleged misrepresentations and omissions of material facts in connection with the purchase or sale of a covered security, where plaintiff alleges misrepresentations and omissions of material facts beginning before the class period but alleges no purchases or sales made in reliance upon, and seeks no damages for, the pre-class period misrepresentations or omissions?

III. Did the Court of Appeals err in holding that Petitioner's common law negligence claim is subject to dismissal under SLUSA because it is "essentially a securities fraud claim"?

## PARTIES TO THE PROCEEDINGS

The following profit-sharing plan was plaintiff/appellant in the Court of Appeals and is Petitioner in this Court:

> Professional Management Associates, Inc. Employees' Profit Sharing Plan.

The putative class was defined as: "All persons who held shares of Green Tree common stock from before January 30, 1996 through January 27, 1998 (the "Class Period")."

No Petitioner has a parent or subsidiary company.

The following company was defendant/appellee and is the Respondent in this Court:

> KPMG, LLP

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## OPINIONS BELOW

The Court of Appeals opinion is reported at *Professional Management Associates, Inc. Employees' Profit Sharing Plan v. KPMG, LLP*, 335 F.3d 800 (8th Cir. 2003), No. 02-3744, and is reproduced in the Appendix (A-8 to A-12).[1] The Report and Recommendation of the Magistrate Judge is reproduced at A-1 to A-6. The Order of the District Court adopting the Magistrate Judge's Report and Recommendation is reproduced at A-7. This Petition is related to that expected to be filed with respect to the Court of Appeals decision in *Professional Management Associates, Inc. Employees' Profit Sharing Plan v. KPMG, LLP*, 345 F.3d 1030 (8th Cir. 2003), No. 03-1936.

## JURISDICTION

The Eighth Circuit filed its opinion and judgment on July 14, 2003. This timely Petition for Writ of Certiorari is filed pursuant to Supreme Court Rule 13, as extended pursuant to Supreme Court Rule 13, subsection 5, by letter from the Clerk dated October 7, 2003. A-13. This Court has jurisdiction pursuant to 28 U.S.C. § 1254.

## CONSTITUTIONAL AND STATUTORY PROVISIONS

1. United States Constitution, Article III, § 2, provides, in part:

> The judicial power shall extend to all cases, in law and equity, arising under this Constitution, the laws of the United States. . .,

2. SLUSA, 15 U.S.C. §§ 77p(b), (c), (d) and (f), 78bb(f)(1), (2), (3) and (5), provide, in part:

(b) Class Action Limitations. No covered class ac-

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[1] All further references to the materials in the Appendix to this Petition will be made by "A-[page number]."

tion based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—

(1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or

(2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

(c) Removal of Covered Class Actions. Any covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).

(d) Preservation of Certain Actions.

(1) Actions under state law of state of incorporation.

(A) Actions preserved. Notwithstanding subsection (b) or (c), a covered class action described in subparagraph (B) of this paragraph that is based upon the statutory or common law of the State in which the issuer is incorporated (in the case of a corporation) or organized (in the case of any other entity) may be maintained in a State or Federal court by a private party.

(B) Permissible actions. A covered class action is described in this subparagraph if it involves—

. . .

(ii) any recommendation, position, or other communication with respect to the sale of securities of the issuer that—

(I) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and

(II) concerns decisions of those equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

(f) Definitions. For purposes of this section, the following definitions shall apply:

(2) Covered class action.

(A) In general. The term 'covered class action' means—

(i) any single lawsuit in which—

(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; . .

## STATEMENT OF THE CASE

### I. Nature of Action; Proceedings and Disposition in the District Court

In this putative class action, Petitioner asserts state common law claims for negligence, negligent misrepresentation, and aiding and abetting breach of fiduciary duty and a claim under the Minnesota Consumer Fraud Act. (First Amended Complaint ("FAC" or "Complaint") ¶¶ 472-511). The claims are based on allegations that the 1995 and 1996 financial statements of Green Tree Financial, Inc. overstated assets and earnings and that Respondent's reports on those financial statements falsely stated that those financial statements were fairly presented in accordance with generally accepted accounting principles, when they were not. (FAC ¶¶ 8-14).

Petitioner brought this action in Hennepin County District Court. On March 1, 2002, Respondent removed the action pursuant to SLUSA, 15 U.S.C. § 77p, 78bb(f). Petitioner then filed its First Amended Complaint. The Complaint was brought on behalf of only those persons who held shares of Green Tree stock during the period January 30, 1996 through January 27, 1998 ("Class Period") (FAC ¶ 35).

On April 1, 2002, Respondent moved to dismiss the Complaint, and Petitioner moved to remand the case to state court. The motion was argued before Magistrate Judge Franklin L. Noel of the United States District Court for the District of Minnesota on May 24, 2002. On July 26, 2002, the Magistrate Judge issued a report recommending that Respondent's motion to dismiss be granted and that Petitioner's motion to remand be denied as moot. (A-1 – A-6). Magistrate Judge Noel found that the Complaint alleged misrepresentations and omissions of material facts in connection with the purchase of a covered security. (A-4 – A-5). He also found that the Complaint alleged misrepresentations and omissions of material facts that began in 1994 and continued into January 1998. (A-5). The Magistrate Judge concluded that the Complaint "implicitly alleges that the misrepresentations and omissions made between these dates were made in connection with the purchase of securities." *Id.*

Petitioner objected to the Report and Recommendation and proposed to amend the Complaint to delete two references to "purchased" and "bought." On August 30, 2002, the District Court, the Honorable Joan L. Ericksen, issued an order adopting the R&R. (A-7). Petitioner sought leave to file a motion to reconsider limited to the District Court's refusal to allow Petitioner to replead to delete the two references to "purchased" and "bought" upon which the Magistrate Judge, in part, based his decision. On September 10, 2002, the District Court denied Petitioner's request for leave to file a motion for reconsideration because the request for leave to amend the Complaint was not accompanied by the proposed amended complaint, as required by the Local Rule, and was, therefore, not properly before the court.[2]

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[2] The Magistrate Judge recognized that Petitioner intended to omit all references to purchases and to limit its claims to *holding* Green Tree shares: ". . . Plaintiffs filed an Amended Complaint dropping one Plaintiff and limiting the proposed class of persons to only those who held shares,

In a further effort to remove the offending language from the Complaint, Petitioner then moved to vacate the judgment pursuant to Federal Rules of Civil Procedure 60 and for leave to file an amended complaint pursuant to Federal Rules of Civil Procedure 15. On October 15, 2002, Magistrate Judge Jonathan G. Lebedoff issued his Report and Recommendation denying the motion to vacate and denying the motion to amend as moot. Petitioner's Notice of Appeal was timely filed on October 30, 2002.

## II. The Court of Appeals Decision

On July 14, 2003, the Court of Appeals filed its judgment affirming the District Court's dismissal of Petitioner's Complaint. The Eighth Circuit agreed with the District Court that, based in part on allegations of misrepresentations and omissions of material facts beginning before the Class Period, in its Complaint Petitioner "implicitly alleges the misrepresentations and omissions were made in connection with the purchase of securities and thus SLUSA requires dismissal." 335 F.3d at 803. The Eighth Circuit rejected Petitioner's argument that SLUSA does not apply where no claims are based on either purchases or sales and where no damages are alleged with respect to purchases or sales. The Eighth Circuit held that SLUSA "is not limited to cases involving damages claimed as a result of the purchase or sale of securities." *Id.*;

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as opposed to purchased shares, of Green Tree stock." (A-2). "[T]he Amended Complaint eliminated one of the class representatives to avoid the representation of an actual purchase or sale of securities." (A-4). In two of the 511 paragraphs of its First Amended Complaint, Petitioner states that it "purchased and held" and that Petitioner and class members "bought and retained" Green Tree stock during the Class Period. Petitioner had advised the District Court that the reference to "purchased" was inaccurate because Petitioner had purchased all of its Green Tree shares before the Class Period. The Complaint uses the word "held" or "hold," or some derivation thereof, as the basis for the claims against Respondent 26 times. The references to "purchased" and "bought" were inadvertent.

15 U.S.C. §§ 77p(b), 78bb(f)(1). The Court of Appeals also held that Petitioner's negligence claim "is essentially a securities fraud claim." 335 F.3d at 803.

## REASONS FOR GRANTING THE WRIT

This Petition presents this Court with an opportunity to address important issues regarding the scope and effect of SLUSA. This Court has not previously addressed this statute. Since 1995, this Court has found occasion to address the application of the Securities Act of 1933 and the Securities Exchange Act of 1934 to private causes of action on only two occasions: *Wharf (Holdings) Ltd. v. United Intern. Holdings, Inc.*, 532 U.S. 588, 121 S.Ct. 1776 (2001) (sale of oral option with secret intent not to honor it violated Rule 10b-5); *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 115 S.Ct. 1061 (1995) ("prospectus" for purposes of § 12(2) (now 12(a)(2)) of Securities Act of 1933 referred to document that describes public offering of securities) (Justice Thomas filing dissenting opinion, in which Justice Scalia, Justice Ginsburg, and Justice Breyer joined, and Justice Ginsburg filing dissenting opinion, in which Justice Breyer joined).

This Petition is timely in view of the recent scandals that have dramatically affected the securities markets and investors. Most of these scandals, like the fraud in this case, involve manipulative accounting practices and fraudulent financial statements. A prominent academic commentator has attributed these scandals to the substantial decline in legal deterrence to auditors' engaging in such conduct in the 1990s, including the passage of SLUSA and the Private Securities Litigation Reform Act of 1995,[3] the statute that SLUSA was intended to reinforce. Coffee, "Understanding Enron: 'It's

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[3] Pub. L. No. 104-67, §§ 27(a)(2)(A), 27A(c), 201(g)(2), 109 Stat. 737, 738, 750, 758-59 (codified as amended in scattered sections of 15 U.S.C.).

About the Gatekeepers, Stupid,'" *The Business Lawyer*, Section of Business Law, American Bar Association, August 2002, vol. 57, no. 1, 1403, 1409-10.[4] Noting that, since the passage of SLUSA in 1998, the numerous reports of accounting fraud have necessarily changed the perspective from preventing nonmeritorious suits to a recognition "that many charges of corporate fraud were neither speculative nor attempts to extort settlement money, but were based on actual misconduct," the California Supreme Court recently concluded that "[e]liminating barriers that deny redress to actual victims of fraud now assumes an importance equal to that of deterring nonmeritorious suits." *Small v. Fritz Companies, Inc.*, 65 P.3d 1255,1263, 132 Cal.Rptr.2d 490, 500 (2003).

## I. The Opinion of the Court of Appeals Conflicts with this Court's Decision in *Blue Chip Stamps* and with other Courts Applying *Blue Chip* to SLUSA by Interpreting SLUSA So Broadly as to Effectively Preempt All Securities Holders' Class Action Claims Based on State Law

The Eighth Circuit held that a complaint that asserts

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[4] Professor Coffee notes that "the spike in earnings restatements in the late 1990s implies that the Big Five [accounting] firms had earlier acquiesced in aggressive earnings management—and, in particular, premature revenue recognition—that no longer could be sustained." *Id.* at 1407. Professor Coffee further notes that the dramatic increase in the 1990s of equity and performance-based compensation provided powerful incentives for top management to cook the books, leading to pressure on gatekeepers (including auditors) to acquiesce in earnings management. The increase in this type of compensation "placed gatekeepers under greater pressure to acquiesce in short-term oriented financial and accounting strategies." *Id.* at 1413-14. *See In re Green Tree Financial Corporation Stock Litigation*, 270 F.3d 645, 661, 664 (8th Cir. 2001) (chief executive officer's exorbitant compensation, which was based on corporation's earnings, was motivating factor in the fraudulent conduct alleged by plaintiffs). This case arises from the same conduct.

state law claims based on misrepresentations and omissions of material facts in connection with the *holding* of a covered security (within the meaning of SLUSA) must be dismissed even though the holder bases no claims on purchases or sales of that security. According to the Eighth Circuit, if purchases occurred at any time during which misrepresentations and omissions of material facts are alleged—in this case prior to the beginning of the Class Period during which the holders' claims are asserted—then the "in connection with a purchase or sale of a covered security" element of SLUSA has been satisfied. Likewise, according to the Eighth Circuit, if sales occurred at any time during which deficient disclosures are alleged, the "in connection with" element is also satisfied, even though no claim could be brought with respect to such sales because there were no damages where it is alleged that the stock value was inflated as a result of the misrepresentations and omissions of material facts.

In its impermissibly broad interpretation of the statute, the Eighth Circuit brings within SLUSA's pre-emptive reach claims that could not be brought under the federal securities laws because they do not satisfy the requirement that the misrepresentations or omissions occur in connection with the purchase or sale of a security. The Eighth Circuit's decision conflicts with *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), and with cases from the Eighth and Eleventh Circuits that have applied *Blue Chip* to limit the scope of SLUSA. The Eighth Circuit's decision also conflicts with cases from the Second and Ninth Circuits that recognize the limited pre-emptive scope of SLUSA.

In its Complaint, Petitioner asserted claims on behalf of itself and other holders of Green Tree stock during the Class Period based on allegations that Respondent provided affirmative assurances that Green Tree's 1995 and 1996 audited financial statements were properly stated in accordance with generally accepted accounting principles when in fact Green Tree's assets, earnings, and stock value were over-

stated, as was revealed when Green Tree was compelled in late 1997 and early 1998 to restate its financial statements. Petitioner also alleged that Green Tree's 1994 financial statements were defective when issued in early 1995, preceding the Class Period, but no claims are based on any purchases or sales or holding during the period following the issuance of Green Tree's 1994 financial statements and January 30, 1996, the beginning of the Class Period.[5]

### A. Petitioner's Class Period Holding Claims Are Not Subject to SLUSA notwithstanding Allegations of Pre-Class Period Defective Disclosures.

Two appellate courts have said that the phrase "in connection with the purchase or sale of a covered security" in SLUSA has the same meaning as the nearly identical phrase has in section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1994), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (2001), thereunder. *Green v. Ameritrade, Inc.*, 279 F.3d 590, 597-8 (8th Cir.2002); *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1345 (11th Cir.2002).

This Court interpreted the "in connection with the purchase or sale" language in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). In that case, this Court considered whether a private cause of action for damages could be maintained under Rule 10b-5 where the offerees neither purchased nor sold any of the offered shares. *Id.* at 725. Section 10 of the Exchange Act makes it "unlawful for any person ... (b) to use or employ, *in connection with the purchase or sale of any security* ..., any manipulative or deceptive device or contrivance." 15 U.S.C. § 78j(b) (emphasis

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[5] Claims based on purchases before January 30, 1996 may be barred by the statute of limitations.

added). Rule 10b-5 repeats the emphasized "in connection with" language of the Act. 17 C.F.R. § 240.10b-5. Noting that Congress had specifically rejected suggestions to broaden the scope of the statute to include mere attempts to purchase or sell a security, this Court refused to broadly interpret that language and held that the plaintiffs lacked standing to sue because they were neither purchasers nor sellers of a security.

Importantly for purposes of considering the proper relationship between SLUSA and claims under state law, this Court in *Blue Chip* expressly recognized that, although holders have no remedy under the Securities Exchange Act of 1934, "[o]bviously, this disadvantage is attenuated to the extent that remedies are available to nonpurchasers and nonsellers under state law." 421 U.S. at 738-39 n. 9. The Supreme Court recently reiterated that the "in connection with" language of section 10(b) and Rule 10b-5 "must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation of § 10(b)." *SEC v. Zandman*, 535 U.S. 813, 820 (2002).

Relying on *Blue Chip*, the Eighth Circuit held that because Section 10(b) and Rule 10b-5 are limited to *actual* purchasers or sellers of the securities, it follows that under SLUSA, 'nonsellers and nonpurchasers of securities are not covered by SLUSA's preemption provision.'" *Green*, 279 F.3d at 598. Similarly, the Eleventh Circuit held that "SLUSA does *not* apply to claims dealing *solely* with the retention of securities, rather than with purchase or sale." *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1345 (11th Cir.2002) (emphasis in original).

Regarding the issue of allegations by a holder of a covered security relating to pre-class period defective disclosures, no other appellate court has addressed this issue. However, three district courts have done so. Two of these courts held that such allegations provide background but do not convert the holders' claims into purchasers' claims where no damages are sought for purchases based on such pre-class

period disclosures. *Gordon v. Buntrock,* No. 00 CV 303, 2000 WL 556763 (N.D.Ill. Apr.28, 2000) (unpublished opinion); *Wai Chinn v. Belfer*, No. Civ.02-00131-ST, 2002 WL 31474189 (D. Ore. Oct. 22, 2002) (unpublished opinion) at *4. The third case, *Zoren v. Genesis Energy, L.P.*, 195 F. Supp.2d 598, 604 (D. Del. 2002), held to the contrary.

### B. SLUSA Does Not Completely Preempt All Securities Fraud Class Actions.

If Congress had intended to provide that all class actions relating to covered securities be brought exclusively in federal court, it would have said so. It could have provided that "all class actions that relate to the purchase, sale or holding of a covered security and the exercise of any and all rights relating to such security shall be brought exclusively in federal court." But SLUSA does not say that; rather, SLUSA concerns itself with a narrower subset: class actions alleging an untrue statement or omission of a material fact made in connection with the purchase or sale of a covered security. *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Incorporated*, 332 F.3d 116, 124 (2d Cir. 2003) ("SLUSA only converts into federal claims those state claims that fall within its clear preemptive scope, thereby confining federal question jurisdiction under this statutory regime to a subset of securities fraud cases.")

The *Spielman* court recognized that "SLUSA was intended to completely preempt the field of *certain types* of securities class actions by essentially converting a state law claim into a federal claim and creating federal jurisdiction and venue for specified types of state securities fraud claims." 332 F.3d at 123-24 (emphasis in original). "SLUSA does not, however, preclude all state enforcement or private causes of action in securities fraud cases." *Id.* at 124.

If SLUSA's prohibition is read as broadly as the Eighth Circuit holds, then there is effectively no class action

left that can be brought in state court on the basis of state law claims related to holding securities. Although SLUSA provides that all "state securities fraud class actions" such as this one are removable, such removal "does not necessarily sound the death knell of the removed action." *Spielman*, 332 F.3d at 124. It is the job of the district court to "determine that the removed action is, in fact, a 'preempted class action.'" *Id.* The district court "must examine the complaint to determine whether the substantive requirements necessary to sustain removal under SLUSA's preemption provision . . . have been satisfied, as these requirements determine whether a district court has subject matter jurisdiction to entertain the action." *Id.* at 124-25 (citations omitted). Here the district court, affirmed by the Court of Appeals, chose to disregard what it acknowledged was Petitioner's purpose to bring a holder's claim and further ignored those claims excluded from, and preserved under, SLUSA.

### C. For a "Covered Class Action" to be Dismissed under SLUSA, There Must Be Purchases or Sales with respect to which the Claimant Was Damaged.

SLUSA mandates the dismissal of a "covered class action" in which claims are asserted based upon state law and upon allegations of "an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. §§ 77p(b)(1), 78bb(f)(1)(a). A "covered class action" is, *inter alia*, a "lawsuit in which damages are sought on behalf of more than 50 persons or prospective class members" or "one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated." 15 U.S.C. §§ 77p(f)(1)(2), 78bb(f)(6)(b).

The Eighth Circuit held that "SLUSA's 'in connection with' requirement is not limited to cases involving damages

claimed as a result of the purchase or sale of securities" but instead "applies to any covered class action alleging an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security." 335 F.3d at 803 (citations omitted). Under this interpretation of SLUSA, a sale by a holder alleging a state law claim based on allegations of inflated stock values, even though not resulting in any damages to the holder, could be deemed to provide the requisite "sale" for SLUSA to apply. Such an interpretation means that facts that would not permit a purchase or sale claim to be made under the federal securities laws could be the basis for dismissing a holder claim under SLUSA.

Reading SLUSA to provide that an incidental purchase or sale—a purchase or sale in connection with which no damages are or could be sought—causes a class action holder claim to be dismissed effectively eliminates state law remedies for holders that this Court in *Blue Chip* recognized. While Congress clearly intended that securities class actions for damages alleging misrepresentations and omissions of material facts arising from the purchase or sale of a covered security be brought in federal court on the basis of the federal securities laws, Congress, by its use of "purchase or sale" did not intend that holder actions be likewise limited to federal court, where there is no remedy.

## II. The Eighth Circuit's Implication of a Claim Not Made by Petitioner Exceeds that Court's Jurisdiction.

Recognizing the Complaint's lack of any claim against Respondent *explicitly* based on misrepresentations or omissions of material facts in connection with the purchase or sale of a covered security, the Eighth Circuit, like the District Court, ruled that the Complaint "*implicitly* alleges the misrepresentations and omissions were made in connection with the purchase of securities. . ." 335 F.3d at 803 (emphasis sup-

plied). The Eighth Circuit so held even though Petitioner does not allege any purchases or sales made in reliance on the alleged misrepresentations and omissions. *Compare*, *Green v. Ameritrade, Inc.*, 279 F.3d 590, 598 (8th Cir. 2002) (SLUSA governs when a complaint "can reasonably be read as alleging a . . . purchase of a covered security made in reliance on the allegedly faulty information provided to [plaintiff] and to putative class members by [the defendant].").[6]

Any purchases made before the beginning of the Class Period and after the issuance of Green Tree's 1994 financial statements in early 1995 do not present a case or controversy because no claim is made by Petitioner as to any such purchases; the only claims made by Petitioner relate to Respondent's conduct during the Class Period.[7] The Eighth Circuit's holding that it had jurisdiction under SLUSA on the basis of "implicit" allegations of misrepresentations and omissions in connection with the purchase or sale of a covered security is contrary to the basic principle that the federal courts have jurisdiction only over actual cases or controversies. U.S. Constitution, Article III, section 2; *Flast v. Cohen*, 392 U.S. 83, 94-97 (1968) (". . . the judicial power of federal courts is constitutionally restricted to 'cases' and 'controversies'"); *Joint Anti-Fascist Refugee Comm. v. McGrath*, 637 U.S. 39, 60 (1951) ("The jurisdiction of the federal courts can be invoked

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6 There can be no doubt that, if Petitioner's Complaint had asserted a claim under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 77j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 (2001), on the basis of the allegations contained in the Complaint, the claim would be dismissed, and properly so, because there are no allegations of purchases or sales in connection with, or in reliance upon, the deficient financial statement disclosures. *See, e.g., Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

7 The implied allegations of purchases made during the pre-Class Period are to be distinguished from the two inadvertent references to "purchased" and "bought" with respect to Class Period allegations addressed in footnote 1 above.

only under circumstances which to the expert feel of lawyers constitute a 'case or controversy'").

The absence of a claim explicitly based on purchases during the pre-Class Period presents no case or controversy; "case or controversy" are words that "limit the business of federal courts to questions presented in an adversary context and in a form historically viewed as capable of resolution through the judicial process." *Flast*, 392 U.S. at 94. For there to be a case or controversy, Article III requires that there be an "injury in fact that has been caused by the challenged conduct and that can be remedied by a judicial decree." *Director, Office of Workers' Comp. Programs v. Perini North River Assocs.*, 459 U.S. 297, 304 (1983) ("The constitutional dimension of standing theory requires, at the very least, that there be an 'actual injury redressable by the court.'").

Federal courts cannot acquire jurisdiction if a claim that would confer such jurisdiction has not been made; there is no such thing, for Article III purposes, as a "theoretical" or "implicit" claim. Yet, the Eighth Circuit held that purchases made before the Class Period confer jurisdiction on the District Court to dismiss Petitioner's action under SLUSA even though Petitioner has made no claim based on any such purchases. *See Consumers Union of U.S. v. Kissinger*, 506 F.2d 136 (D.C. Cir. 1974), *cert. denied*, 421 U.S. 1004 (1975) (antitrust count in a complaint that had been dismissed with prejudice did not constitute a controversy that would support judicial declaration with respect to said count); *Barnosky Oils, Inc v. Union Oil Co.*, 665 F.2d 74, 87 (6th Cir. 1981) (district court's judgment that addressed claim not made by the parties vacated because it is advisory and not a case or controversy); *Young v New York City Transit Auth.*, 903 F.2d 146 (2d Cir.), *cert. denied*, 498 U.S. 984 (1990) (ruling that a statute was invalid reversed because claim was made by plaintiffs at court's direction and plaintiffs lacked standing).

SLUSA cannot confer jurisdiction that Article III withholds. A statute must be interpreted so as to be constitu-

tional. *Frisby v. Schultz*, 487 U.S. 474, 475 (1988) (it is a "well-established principle that statutes will be interpreted to avoid constitutional difficulties"); *see also Edward J. DeBartolo Corp. v. Florida Gulf Coast Building & Constr. Trades Council*, 485 U.S. 568, 575 (1988); *United States ex rel. Attorney General v. Delaware & Hudson Co.*, 213 U.S. 366, 408 (1909). When interpreting a statute (such as SLUSA) that deals "with the intersection of federal and state law," Article III requires that the federal courts "scrupulously confine their own jurisdiction to the precise limits which (a federal) statute has defined." *Victory Carriers, Inc. v. Law*, 404 U.S. 202, 212-13 (1971) (citation and internal quotation omitted). Under these circumstances, the federal courts "should proceed with caution in construing constitutional and statutory provisions dealing with the jurisdiction of the federal courts." *Id.*

Likewise, to the extent that the Eighth Circuit's opinion may be read as holding that any sales by a holder during a class period provides the requisite purchase or sale connection for SLUSA purposes (even though the allegations in the action relate to inflated assets, earnings and stock values), thereby giving the federal court jurisdiction, the decision runs afoul of Article III. Because any such sale of a covered security under those circumstances presents no case or controversy over which the federal courts can exercise jurisdiction, any such sale, even if made during a period in which the issuer's financial statements were misleading, cannot be a basis for federal court jurisdiction. Thus, while any such sales may arguably bring the action within SLUSA for removal purposes (notwithstanding the absence of any allegations of deceptively induced sales and the absence of any injury), upon a proper analysis by the district court of whether it had jurisdiction, in the absence of a case or controversy with respect to any such sales, the district court has no jurisdiction and must remand. *See Spielman*, 332 F.3d at 124 ("Quite simply, a district court must examine the complaint to determine whether

the substantive requirements necessary to sustain removal under SLUSA's preemption provision . . . have been satisfied, as these requirements determine whether a district court has subject matter jurisdiction to entertain the action.") (citations omitted).

A federal court cannot assert jurisdiction over a matter on the basis of a claim that was not made and that could not be made because there was no injury. Likewise, a federal court cannot assert jurisdiction over a matter on the basis of a claim that was not made even if there was an injury. Because Petitioner has not asserted a claim in connection with any sales of its Green Tree shares and has also not asserted a claim in connection with any purchases of its Green Tree shares during the pre-Class Period, nor purports to assert such claims on behalf of anyone else, the District Court had no jurisdiction over this matter.

It is well settled that the party who brings a suit may decide what law to rely upon and may avoid raising a federal question by exclusive reliance on state law. *See Holmes Group, Inc v. Vornado Air Circulation Sys., Inc.*, 535 U.S. 826, 831 (2002); *Caterpillar, Inc. v. Williams*, 482 U.S. 386, 392 (1987) (plaintiff is the "master of the claim" and "may avoid federal jurisdiction by exclusive reliance on state law"); *The Fair v Kohler Die & Specialty Co.*, 228 U.S. 22, 25 (1913) (Holmes, J.) ("Of course, the party who brings a suit is master to decide what law he will rely upon. . ."). Questions concerning federal question jurisdiction are guided by the well-pleaded complaint rule that states that if the plaintiff's complaint raises no issues of federal law, federal question jurisdiction is lacking. *Hart v. Bayer Corp.*, 199 F.3d 239, 244 (5th Cir. 2000); *Wald v. CM. Life Ins. Co.*, 2001 U.S. Dist. LEXIS 2593, at *12 (N.D. Tex. Mar. 8, 2001).[8] The court

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[8] Complete preemption, when triggered, is an exception to the well-pleaded complaint rule. *Spielman*, 332 F.3d at 124 n. 5. Complete preemption applies only where the statute can be said to have extraordi-

cannot redraft Petitioner's Complaint to include claims that Petitioner saw fit to exclude. *MDCM Holdings, Inc. v. Credit Suisse First Boston Corp.*, 216 F. Supp.2d 251, 258 (S.D.N.Y. 2002) (neither court nor defendant has the right to redraft plaintiff's complaint to include new claims).

## III. Petitioner's Negligence Claim Is Not Subject to SLUSA and Does Not Confer Jurisdiction on the Federal Court.

The Court of Appeals held that Petitioner's negligence claim "is essentially a securities fraud claim." 335 F.3d at 803. A negligence claim is not "essentially a securities fraud claim." Putting aside the purchaser-holder issue, Petitioner seeks recovery for losses suffered as a result of inflated stock that traded in the secondary markets because of negligent audits that permitted Green Tree to overstate assets and earnings. Such a "securities fraud claim" under the federal securities laws requires a plaintiff to prove scienter, among other elements. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). Petitioner's negligence claim is not a "fraud" claim, even if it is deemed to be on behalf of purchasers of a covered security.

In order for a claim to be subject to removal under SLUSA, it must allege a material misrepresentation or omission. 15 U.S.C. § 78bb(f)(2). Petitioner's negligence claim does not satisfy SLUSA, as there is no allegation of a misrepresentation, omission, or the employment of any manipulative or deceptive device. Petitioner's negligence claim against Respondent is based on Respondent's negligent audits of

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nary preemptive power because the effect of triggering this doctrine is to wholly preempt claims that fall within the preemptive scope of the particular statute. *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S. 58, 64-66, 107 S.Ct. 1542, 95 L.Ed.2d 55 (1987). As discussed above, SLUSA does not preclude all state private causes of action in securities fraud cases. 332 F.3d at 124.

Green Tree's 1995 and 1996 financial statements. Petitioner alleges that "KPMG failed to exercise that degree of diligence and due care plaintiff and the class were entitled to expect of an auditing firm such as KPMG." (FAC ¶ 498). These allegations do not satisfy SLUSA. *See MDCM Holdings, Inc. v. Credit Suisse First Boston Corp.*, 216 F. Supp.2d 251, 256 (S.D.N.Y. 2002) (state law claim that does not involve allegations of misrepresentation or omissions by defendant not preempted by SLUSA); *Simon v. Internet Wire, Inc.*, 2001 WL 688542, *3 (C.D. Cal. Apr. 3, 2001) (state law claims for negligence not preempted by SLUSA); *Burns v. Prudential Securities*, 116 F. Supp.2d 917, 923-25 (N.D. Ohio 2000).

Accordingly, to the extent that the Complaint is read as including in the negligence claim misrepresentations and omissions of material fact, as the Eighth Circuit does, such misrepresentations and omissions are mere surplusage to the claim. Because misrepresentations and omissions of material fact are not elements of a state common law negligence claim, a federal court cannot create jurisdiction where none otherwise exists simply by construing a claim to include elements that under applicable law are not included. Parties cannot confer on a federal court jurisdiction that it does not have. Wright, Miller & Cooper, *Federal Practice and Procedure: Jurisdiction and Related Matters* § 3522 at p. 66. Parties cannot waive lack of jurisdiction by express consent, *Sosna v. Iowa*, 419 U.S. 393 (1975), by conduct, *Mitchell v. Maurer*, 293 U.S. 237 (1934), or by estoppel. *American Fire & Cas. Co. v. Finn*, 341 U.S. 6, 17-18 (1951). "[T]he subject matter jurisdiction of the federal courts is too basic a concern to the judicial system to be left to the whims and tactical concerns of the litigants." Wright, Miller & Cooper, § 3522 at 67-68.

Petitioner could not, if it had wanted to, plead its negligence claim in a manner (e.g., by including non-essential elements such as misrepresentations in connection with the purchase of a security) that would confer jurisdiction on the federal courts. The Eighth Circuit improperly interpreted the

Complaint in a manner that, in effect, pleaded Petitioner into the federal court jurisdiction that Petitioner sought to avoid.[9]

The District Court did not have jurisdiction to dismiss Petitioner's negligence claim, which it did without even addressing the claim. In improperly affirming the dismissal, the Court of Appeals construed the Complaint as including in the claim elements that are not required to establish the claim. Such a construction of Petitioner's negligence claim, done for the purpose of obtaining jurisdiction over Petitioner's action, is an impermissible extension of the court's Article III limited jurisdiction.[10]

## IV. The Action Is Required To Be Remanded in Its Entirety.

Under SLUSA's peculiar textual structure, if the action involves a state claim that has been preserved, the entire

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[9] Even incorporating into a state law negligence claim a standard provided by federal law does not give the federal courts jurisdiction over the state law claim. *Merrell Dow Pharmaceuticals, Inc. v. Thompson*, 478 U.S. 804, 808 (1986).

[10] The Complaint also included a claim for aiding and abetting the breach of the Green Tree directors' fiduciary duty of candor under Delaware law. (Complaint ¶¶ 472-88). Neither the District Court nor the Court of Appeals addressed this claim. Such a claim has been held to have been preserved by SLUSA. *Greaves v. McAuley*, 264 F. Supp. 2d 1078, 1082 (N.D. Ga. 2003) (court required to remand plaintiff's state-law claims alleging misrepresentations and omissions that satisfied "Delaware carve-out"); *Gibson v. PS Group Holdings, Inc.*, 2000 WL 777818, at *6 (S.D. Cal. March 8, 2000) ("Delaware carve-out" exception to SLUSA, found at 15 U.S.C. § 77p(d)(1) and 15 U.S.C. § 78bb(f)(3)(A), permits plaintiffs to bring class action lawsuits where a corporation or its principals breach a fiduciary duty of disclosure to existing shareholders, *citing Malone v. Brincat*, 722 A.2d 5, 13 (Del. 1998)); *Lalondriz v. USA Networks, Inc.*, 54 F. Supp.2d 352, 354 (S.D.N.Y. 1999) (claim that defendant and its directors breached their fiduciary duty when they failed to disclose problems associated with a new venture that defendants knew rendered the venture unlikely to succeed was excluded from SLUSA pursuant to §78bb(f)(3)(A)(i)).

action must be remanded, including those preempted state claims that, in the absence of the preserved claim, would cause the action to be dismissed. 15 U.S.C. § 77p(b); 15 U.S.C. § 78bb(f)(2); *Greaves*, 264 F. Supp. 2d at 1084. In *Greaves*, the court considered whether an action was properly removed from state to federal court and then whether that action was required to be remanded to state court on the basis of preserved claims. The court concluded that, under the plain meaning of the statute, an action properly removed that included a preserved state law claim must be remanded in its entirety:

> Pursuant to the sequencing of the analysis in the statute, this court must first determine if the entire action involves [any] allegations that permit removal. 15 U.S.C. § 77p(b), (c). If removal is appropriate, the court must then determine if any exception in [15 U.S.C. § 78bb(f)(4)] preserves jurisdiction in state court. If jurisdiction in state court is preserved, then the federal court "shall remand such action." [15 U.S.C. § 78bb(f)(4)]. Thus, if an action has been removed, but part of the action fits the Delaware carve-out, "the action may be maintained in State court" and "the Federal court shall remand such action to State court." *Id.* In essence, according to the plain language of the statute, the court is to consider the propriety of remand after determining the propriety of removal. *Id.* If remand is appropriate, the entire lawsuit must be returned to state court, irrespective of the court's decision regarding removal. As such, the remand provision trumps the removal provision, and the entire lawsuit must be remanded.

2003 WL 21277274, at *6

The court in *Greaves* acknowledged defendants' argument that such an interpretation of SLUSA means that the simple inclusion of a preserved state law claims defeats federal jurisdiction over those claims that clearly are preempted by SLUSA, so that the limited exceptions from SLUSA tend to swallow the entire statute. Although the court did so acknowledge the argument, it need not have done so. It is not at all apparent that all states have a state law disclosure doctrine like the "Delaware carve-out" that imposes a duty of disclosure on corporate directors.[11] *See Malone v. Brincat,* 722 A.2d 5, 13 (Del. 1998).

## CONCLUSION

This petition raises significant questions about the preemptive scope of SLUSA and federal jurisdiction over state common law and statutory claims relating to securities and the protection of investors. The Eighth Circuit's decision raises profound questions concerning the relationship between state law and federal jurisdiction regarding such claims. The Eighth Circuit's interpretation of SLUSA's reach exceeds both the court's and the statute's constitutional grasp. By finding implicit allegations and claims not explicitly pleaded as a basis for recovery, the Court of Appeals has exceeded its jurisdiction. By holding that any sale or purchase, without regard to whether such sale or purchase was injurious to a se-

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[11] The *Greaves* interpretation of SLUSA would seem to apply only to expressly preserved state law claims, not to state law claims that can be maintained in state court simply because they do not contain the elements required for a claim subject to SLUSA (e.g., negligence and misrepresentations and omission in connection with holding, versus buying or selling, securities). Thus, where a state does not impose a fiduciary duty of candor on the directors of those corporations incorporated therein, a "Delaware carve-out" claim does not exist and cannot be used to defeat SLUSA's preemptive power.

curities holder seeking to assert state law claims, is sufficient to bring SLUSA into play, the Court of Appeals ignores the Article III requirement that an actual case or controversy exist for the court to have jurisdiction. By brushing aside the critical differences between a state law claim for negligence and a federal securities fraud claim, the court has substantially undermined the role of state law in providing protection to investors that this Court recognized in *Blue Chip Stamp*. By imputing to Petitioner claims that Petitioner has not made, the court denied Petitioner's mastery of its complaint. This petition offers this Court the opportunity to define the appropriate parameters of SLUSA and is particularly timely in view of the burgeoning litigation related to the recent spate of financial scandals.

Respectfully submitted,

Date: December 11, 2003

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UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Professional Management Associates, Inc., et al.,

Civil No. 02-492 JEL/JGL

Plaintiffs,

v. **REPORT AND RECOMMENDATION**

KPMG LLP,

Defendant.

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Vernon J. Vander Weide, Gregg M. Fishbein, Karl L. Carnbronne, and John A. Cochrane, for Plaintiffs.
Tom Hatch, Randall Tietjen, and Douglas R. Boettge, for Defendant.

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**THIS MATTER** came before the undersigned United States Magistrate Judge for a hearing on May 24, 2002, on: (1) Defendant's Motion to Dismiss [# 13]; (2) Plaintiff's Motion to Remand to State Court [# 16]. This matter was referred to the undersigned for Report and Recommendation pursuant to 28 U.S.C. § 636. For the reasons which follow, this Court will recommend that Defendant's motion to dismiss be granted, and Plaintiff's motion to remand to State Court be denied.

## 1. PROCEDURAL AND FACTUAL BACKGROUND

On January 30, 2002, Plaintiff, Professional Management Associates, Inc. Employees' Profit Sharing Plan, ("The Plan" or "Plaintiff") filed a Complaint in state court

against Defendant, KPMG LLP ("KPMG" or "Defendant"). This Complaint purported to be filed on behalf of a class of persons who purchased or held shares of Green Tree Financial Corporation ("Green Tree"). This action sought to recover damages allegedly caused by negligent and wrongful conduct in connection with audits and reviews of Green Tree's financial statements during the class period from January 30, 1996 through January 27, 1998. According to the Complaint, the Plan was a shareholder in Green Tree, that purchased and held 900 shares in Green Tree. Defendant is an independent auditor that reviewed and prepared Green Tree's yearend and quarterly financial statements.

Plaintiff's Complaint sets forth only statutory and common-law claims under state law provisions. Defendant removed the action to federal court on March 1, 2002, pursuant to the Securities Litigation Uniform Standards Act of 1998 ("SLUSH"), 15 U.S.C.§§ 77p, 78bb(f). On March 12, 2002, Plaintiffs flied an Amended Complaint dropping one Plaintiff and limiting the proposed class of persons to only those who held shares, as opposed to purchased shares, of Green Tree stock. On April 1, 2002, Defendant moved to dismiss the Complaint. The next day Plaintiff made a motion to remand the case to state court.

## III. CONCLUSIONS OF LAW

### A. Defendant's Motion to Dismiss Should Be Granted[1]

Under the SLUSH, Congress provided that any class action covered under the Act could be removed to federal court and dismissed. See 15 U.S.C. § 78bb(f)(1), (2).

SLUSA mandates that any class action based on an allegation that a "covered security" was sold through misrepresentation, manipulation, or deception shall be removable to federal court, and then dismissed. In re Lutheran Bhd. Variable Ins. Prods. Co. Sales Practices Litig., 105 F.Supp.2d 1037, 1039 (D.Minn. 2000).

A party seeking to establish that a claim falls within SLUSA's preemptive scope must show that the claim satisfies four criteria:

> (1) the action is a "covered class action" under SLUSA, (2) the action purports to be based on state law, (3) the defendant is alleged to have misrepresented or omitted a material fact (or to have used or employed any manipulative or deceptive

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[1] The Court rejects Plaintiff's retroactivity argument. The statute is clear that it applies to actions other than those which were already pending on the date of enactment. See 15 U.S C. §77p(Note) ("The Amendments made by this section shall not apply to any action commenced before and pending on the date of enactment of this Act"). In Re: Bank America Corp., Sec. Lit., 95 F.Supp.2d 1044, 1046 n.2 (E.D. Mo. 2000). As the instant action was filed over three years after SLUSA was enacted, its provisions clearly apply to this case. But see Huff Asset Mngt. v. BT Securities Corp.,190 F. Supp. 2d 1273 (N.D. Ala. 2001) (SLUSA does not apply to pre-enactment conduct in lawsuit filed after the law was enacted).

> device or contrivance), and (4) the defendant is alleged to have engaged in conduct described by criterion (3) "in connection with" the purchase or sale of a "covered security."

15 U.S.C. § 78bb(f)(1)-(2); Green v. Ameritrade. Inc., 279 F.3d 590 (8th Cir. 2002).

In the present case, only the fourth element is in dispute; whether the Complaint alleges wrong-doing "in connection with" the purchase or sale of a "covered security." If the Plaintiff's Complaint does allege wrong-doing in connection with the purchase or sale of a covered security, the statute requires the Defendant's Motion to Dismiss be granted and the Plaintiff's Motion to Remand be denied. On its face, the Plaintiff's Amended Complaint alleges wrongdoing (in particular, "a misrepresentation or omission of a material fact") in connection with the purchase and sale of securities.

Plaintiff contends that the original Complaint was purged of any of the allegations of the specified wrong-doing in connection with the sale or purchase of the securities at issue. Plaintiff argues that it intends to allege only that Defendant's wrong-doing impacted the *"holders"* of the securities in question (as opposed to those who were induced to buy or sell the securities). Defendant contends that the Amended Complaint merely tried to obscure the nature of its allegations, it did not change the substance of the original Complaint.

Plaintiff argues that it intends for the Amended Complaint to omit any reference to a sale or purchase. Moreover, the Amended Complaint eliminated one of the class representatives to avoid the representation of an actual purchase or sale of securities. Nevertheless, Plaintiff failed to

achieve its goal.[2] The Amended Complaint still alleges misrepresentations and omissions of material facts in connection with the purchase of a covered security. For example, the Amended Complaint ¶19 alleges "Plaintiff purchased and held 900 shares of Green Tree common stack from time to time during the class period."

More explicitly, ¶ 466 states, "As a direct result of Green Tree's false and misleading financial statements, and KPMG's false reports thereon, Plaintiff and Class Members . . . bought and retained their Green Tree shares, and did not sell their shares, in belief that said shares were properly valued in the market and without knowledge that Green Tree's earnings and the value of Green Tree's assets and shareholder and

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[2] It is undisputed that the Amended Complaint alleges misrepresentations and omissions of material fact. E.g. ¶ 4 of the Amended Complaint alleges that Green Tree and the Defendant misrepresented to investors, Green Tree's growth and profitability by materially overstating; the financial reports. "[K]PMG knowingly, . . . failed to disclose or to reflect in their public statements and reports that Green Tree had materially misrepresented critical assumptions utilized by [Green Tree] in calculating the gain-on sale revenue recognized by the Company in connection with the securitization of pools of loans it originated." ¶430 of the Amended Complaint states, "if KPMG had not failed in its auditing function as described herein but instead had properly conducted its audits and reviews of Green Tree's financial statements for Green Tree's fiscal years ended December 31, 1994, 1995, and 1996, and the quarters encompassed by those fiscal years and 1997 with the care and diligence reasonably expected by Plaintiff and the Class. . .." The question here is whether these misrepresentations and omissions are alleged in the complaint to have been made in connection with the purchase or sale of a covered security.

shareholder equity were substantially less than Green Tree reported them to be . . .." Id. at ¶466.

Moreover, the Amended Complaint clearly alleges that the misrepresentations and omissions of material fact began in 1994 and continued into January 1998. The class Plaintiff seeks to represent is defined as those investors who held Green Tree shares between January 30, 1996, and January 27, 1998. Plaintiff contends that it has carefully not made any allegation of any purchase or sale during this class period. Assuming without deciding that Plaintiff could avoid the effect of SLUSA by such artful pleading, again Plaintiff failed to achieve its purpose. By alleging misrepresentations and omissions of material fact beginning in 1994, and by limiting the class to those investors who held their shares before January 30, 1996, the Plaintiff has necessarily included in the class investors who purchased their shares between 1994 and January 30, 1996. The complaint, therefore, implicitly alleges that the misrepresentations and omissions made between these dates were made in connection with the purchase of securities.

This Court concludes that it matters not that the proposed class does not base its claim for relief on the wrong-doing in connection with the purchase and sale, the statute clearly applies to any covered class action "alleging" specified wrong-doing "in connection with the purchase and sale of a covered security." As the Amended Complaint achieves the requisite connection between the wrong-doing and "the purchase and sale of a covered security," the Complaint must be dismissed.

In light of this Court's conclusion that SLUSA requires the dismissal of the Complaint, the Plaintiff s Motion to Remand to State Court must be denied as moot.

## IV. RECOMMENDATION

Based upon the files, records, and proceedings herein, **IT IS HEREBY RECOMMENDED** that:

1. Defendant's Motion to Dismiss [#13] be **GRANTED**; and

2. Plaintiff's Motion to Remand to State Court [#16] be **DENIED as Moot**.

DATED: 7-26, 2002

s/
FRANKLIN L. NOEL
United States Magistrate Judge

Pursuant to Local Rule 72.1(c)(2), any party may object to this Report and Recommendation by filing with the Clerk of Court and serving on all parties, within ten days of this Report and Recommendation, written objections which specifically identify the portions of the proposed findings, recommendations or report to which objection is being made, and a brief in support thereof. A party may respond to the objecting party's brief within ten days after service thereof. All briefs filed under this rule shall be limited to ten pages. A judge shall make a de novo determination of those portions to which objection in made.

Unless the parties are prepared to stipulate that the District Court is not required by 28 U.S.C §636 to review a transcript of the hearing in order to resolve all objections made to this Report and Recommendation, the party making the objections shall timely order and cause to be filed within 10 days a complete transcript of the hearing.

This Report and Recommendation does not constitute an order or judgment of the District Court, and it is therefore not appealable to the Circuit Court of Appeals.

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
02-CV-492 (JEL/JGL)

Professional Management Associates,
Inc. Employees' Profit Sharing Plan,
on behalf of itself and all others similarly
situated,

Plaintiffs,

vs. ORDER

KPMG LLP,

Defendant.

Plaintiffs object to the Report and Recommendation, issued July 29, 2002, by the Honorable Franklin L. Noel, United States Magistrate Judge. Plaintiff' s objections to the Report and Recommendation were timely filed pursuant to D. Minn. R. 72.1(c)(2).

The Court has conducted a de novo review of the record. Based on that review, the Court adopts the Magistrate's Report and Recommendation. Therefore, IT IS ORDERED THAT:

1. Defendant's motion to dismiss is GRANTED [Docket No. 13].

2. Plaintiff's motion to remand to state court is DENIED as moot [Docket No. 16].

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: August 30, 2003

s/
JOAN LANCASTER
United States District Judge

**United States Court of Appeals**
**FOR THE EIGHTH CIRCUIT**

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No. 02-3744

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Professional Management Associates, Inc. Employees' Profit Sharing Plan, on behalf of itself and all others similarly situated,

Appellant,

Appeal from the United States District Court for the District of Minnesota.

v.

KPMG LLP,

Appellee.

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Submitted: May 15, 2003

Filed: July 14, 2003

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Before LOKEN, Chief Judge, FAGG and MURPHY, Circuit Judges.

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FAGG, Circuit Judge.

The Securities Litigation Uniform Standards Act of 1998 (SLUSA), 15 U.S.C. §§ 77p(b)-(c), 78bb(f)(1)-(2) (2000), provides for removal to federal court and immediate

dismissal of certain class actions based on state law alleging an untrue statement or omission of a material fact made in connection with the purchase or sale of a covered security. See Dudek v. Prudential Sec., Inc., 295 F.3d 875, 877 & n.1 (8th Cir. 2002). Professional Management Associates, Inc. Employees' Profit Sharing Plan (PMA), a holder of Green Tree Financial Corporation stock, brought this class action in Minnesota state court against KPMG LLP, an independent auditing and accounting firm that reviewed Green Tree's financial statements. After KPMG removed the action to federal district court, PMA amended its complaint alleging state law claims for violations of the Minnesota Consumer Fraud Act, for aiding and abetting a breach of fiduciary duty of disclosure under Delaware law, and for violations of the common law doctrines of negligence and negligent misrepresentation. PMA alleged that KPMG made or assisted in making misrepresentations or omissions of material fact about Green Tree as early as 1994, before class investors purchased Green Tree shares. KPMG moved to dismiss the amended complaint under SLUSA, and PMA, moved to remand. The district court* concluded PMA's first amended complaint implicitly alleged misrepresentations and omissions in connection with the purchase of a covered security, and dismissed the complain under SLUSA. PMA appeals the dismissal and the district court's denial of PMA's request for leave to file a second amended complaint. We affirm.

On appeal, PMA contends the first amended complaint does not implicitly allege any misrepresentation in connection with the sale or purchase of a security. We disagree. According to PMA's first amended complaint, beginning in 1994 and continuing through 1997, Green Tree

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* The Honorable Joan N. Ericksen, United States District Judge for the District of Minnesota.

made material false statements and omissions about its financial condition. KPMG allegedly aided and abetted Green Tree in making these statements and omissions and made its own material false statements and omissions in its audit reports on Green Tree's 1994-96 financial statements. PMA later bought and held shares of Green Tree stock "from time to time during the Class Period" of January 30, 1996 to January 27, 1998. First Amended Complaint ¶¶19,1. "As a direct result of Green Tree's false and misleading financial statements, and KPMG's false reports thereon, [PMA] and class members ... bought and retained their Green Tree shares, and did not sell their shares, in the belief that said shares were properly valued in the market and without knowledge that Green Tree's earnings and the value of Green Tree's assets and shareholder equity were substantially less that Green Tree reported them to be . . . ." Id. ¶466. PMA allegedly suffered damages when the truth about Green Tree's past financial performance was disclosed and its artificially-inflated share price began to fall.

The allegations in PMA'S first amended complaint place it squarely within SLUSA's parameters. Because PMA alleges misrepresentations and omissions of material fact beginning in 1994 and the class investors bought and held their shares later, PMA's complaint implicitly alleges the misrepresentations and omissions were made in connection with the purchase of securities and thus SLUSA requires dismissal. We have previously held the allegation that misconduct caused a plaintiff to invest in inappropriate securities is a claim in connection with the purchase or sale of a covered security for purposes of SLUSA preemption. Dudek, 295 F.3d at 878-79. Further, we have stated SLUSA governs when a complaint "can reasonably be read as alleging a ... purchase of a covered security made in reliance on the allegedly faulty information provided to [the plaintiff] and to putative class members by [the defendant]." Green v. Ameritrade, Inc., 279 F.3d 590, 598 (8th Cir. 2002). PMA

cannot avoid preemption by asserting it is only claiming damages suffered as a result of holding its stock. See Zoren v. Genesis Energy L.P., 195 F. Supp. 2d 598, 604 (D. Del. 2002). SLUSA's "in connection with" requirement, 15 U.S.C. §§ 77p(b), 78bb(f)(1), is not limited to cases involving damages claimed as a result of the purchase or sale of securities. Instead, SLUSA applies to any covered class action alleging an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security. Id. §§ 77p(b)-(c), 78bb(f)(1)-(2).

PMA also contends we should remand its negligence claim because there is no allegation of a misrepresentation or omission in connection with it. PMA's allegations regarding KPMG's misrepresentations and omissions are incorporated by reference in the negligence count, however. First Amended Complaint ¶495; Prager v. Knight/Trimark Group, Inc., 124 F. Supp. 2d 229, 235 (D.N.J. 2000). Because PMA's negligence claim is essentially a securities fraud claim, SLUSA governs. Dudek, 295 F.3d at 879-80.

PMA next asserts the district court committed error in applying SLUSA retroactively to pre-enactment conduct. SLUSA was enacted on November 3, 1998, and the "effective date" note appended to § 77p states it does not "apply to any action commenced before and pending on the date of [its] enactment." Although the complaint in this case was filed more than three years later, PMA argues the statute applies retroactively because the challenged conduct occurred before SLUSA became law. The mere fact that the challenged conduct occurred before the statute's enactment does not mean the statute operates retroactively, however. Landgraf v. USI Film Prods., 511 U.S. 244, 269 (1994). There is generally no retroactivity concern when a new procedural rule goes into effect after a cause of action accrues, but before filing of a lawsuit based on pre-enactment conduct. Id. at 275. "Because rules of procedure regulate secondary rather than primary

conduct, the fact that a new procedural rule [is] instituted after the conduct giving rise to the suit does not make application of the rule [] retroactive." Id.

Here, the relevant conduct regulated by the statute is secondary conduct, the filing of the lawsuit, not the primary, allegedly illegal pre-enactment conduct. Gray v. Seaboard Sec., Inc., 241 F. Supp. 2d 213, 218 (N.D.N.Y. 2003); see Landgraf, 511 U.S. at 291(Scalia, J. concurring). The statute simply establishes a procedural rule regarding the filing of class action lawsuits alleging securities fraud, so no retroactivity analysis is warranted. Gray, 241 F. Supp. 2d at 217. We thus conclude SLUSA applies to all actions commenced after its enactment, even if the challenged conduct predates SLUSA. Id. at 217-18. Applying a retroactivity analysis, we reach the same conclusion. W.R. Huff Asset Mgmt. Co. v. Kohlberg Kravis Roberts & Co., 234 F. Supp. 2d 1218, 1221-26 (N.D. Ala. 2002). Because the complaint in this case was filed more than three years after SLUSA's enactment, SLUSA applies to this action.

Last, the district court did not commit error in denying PMA's "request" for leave to file a second amended complaint. Local Rule 15.1 of the District of Minnesota required PMA to file and serve a motion and attach a copy of the proposed amended pleading. PMA did not do so. Instead, PMA merely inserted a request to file another amended complaint in its brief appealing from the magistrate judge's report and recommendation. Given these circumstances, the district court did not abuse its discretion in denying PMA leave to file a second amended complaint. Dudek, 295 F.3d at 880. Amendment would be futile anyway. Wiles v. Capitol Indemnity, Corp., 280 F.3d 868, 871 (8th Cir. 2002) (leave to amend should be denied when proposed amendment would be futile). In another action, the same district court dismissed the same complaint PMA sought leave to file.

We thus affirm the district court.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT.

**Supreme Court of the United States**
**Office of the Clerk**
**Washington, DC 20543-0001**

William B. Suter
Clerk of the Court
(202) 479-3011

October 7, 2003

Mr. Vernon J. Vander Weide
Head, Seifert & Vander Weide
333 South Seventh Street
Suite 1140
Minneapolis, MN 55402-1823

Re: Professional Management Associates, Inc.
Employees' Profit Sharing Plan, etc.
v. KPMG, LLP
Application No. 03A293

Dear Mr. Vender Weide:

The application for an extension of time within which to file a petition for a writ of certiorari in the above-entitled case has been presented to Justice Thomas, who on October 7, 2003 extended the time to and including December 11, 2003.

This letter has been sent to those designated on the attached notification list.

Sincerely,
William H. Suter, Clerk

By: s/_____

Ruth Jones
Case Analyst